

M e m o r a n d u m

To : Honorable John Chiang, Chairman
Honorable Claude Parrish, Vice Chairman
Miss Betty T. Yee, Acting Member
Honorable Bill Leonard
Honorable Steve Westly

August 24, 2005

From : Kristine Cazadd, Chief Counsel
Legal Department, MIC:83 *K. Cazadd*

Subject : Continuation of Limited Peace Officer Status

On August 24, 2004, as authorized by AB 71, the Board approved Limited Peace Officer ("LPO") status for 27 Investigations Division staff and directed staff to provide a report to the Board in six months. This initial Board authorization of LPO status was to expire in six months unless renewed by the Board. In February 2005, the Board extended LPO status for 27 Investigations Division staff and directed the Chief Counsel to provide another report and recommendation to the Board at the August, 2005 Board Meeting.

Based on the program's success to date, summarized below, staff recommends the continuation of LPO status for 24¹ Investigations Division staff and the "phase-in" of an additional 53 Investigations Division staff (Attachment A), until the Board's legislative authority to grant LPO status expires on January 1, 2010 (Penal Code §830.11(d)). This recommended action allows for the effective implementation of AB 71 at the organizational patterns and staffing models utilized by other agencies with law enforcement status. Upon completion of the phase-in, LPOs would include 40 inspectors, 28 investigators, 2 forensic specialists, 2 area administrators, 4 supervising investigators, and the division chief for a total of 77. The proposed phase-in would continue LPO status for 24 existing LPO staff effective September 1, 2005; classify another 32 or less (depending on core training) with LPO status during November 2005; classify an additional 8 or less with LPO status in December 2005; and classify an additional 13 of those remaining with LPO status by August 2006, or when 12 months on-the-job training has been completed.

Staff will report to the Board every six months on the status and operational efficiency of the LPOs and the programs they administer.

In summary:

- LPO status is a key element of the Board's implementation of the Cigarette and Tobacco Products Licensing Act of 2003, Assembly Bill 71 (AB 71).

¹ Three (3) of the initial delegated LPO positions are currently vacant.

- LPOs have significantly contributed to the implementation of AB 71. Revenue recovery is meeting projections. The June 8, 2005, *State of General Fund Cash Receipts and Disbursements* published by the State Controller shows a \$5,303,000 increase to the General Fund from cigarette tax revenue (of the 87 cent per pack cigarette tax, 10 cents is deposited in the General Fund). Based on the \$5,303,000, staff estimates a total revenue increase (cigarette and tobacco products tax and sales tax) in FY 04/05 of \$82,125,821 (Attachment B). The General Fund revenue increase from this amount is \$18,760,704.
- The Investigations Division, on November 15, 2004, began writing civil citations and criminal citations on May 9, 2005. Citations written by LPOs encourage voluntary compliance which supports legitimate taxpaying businesses that have lost market share to tax evaders.
- The deterrent effect of LPOs is demonstrated by a 5% decrease in cigarette and tobacco product seizures over a one-year period. (Attachment C). The reduced seizure rate means that more legitimate tax-paid product is being sold.
- The Attorney General recognizes the value of LPOs for field enforcement of the Master Settlement Agreement (MSA). The citations and investigations conducted by LPOs are essential to the field enforcement of the MSA which provides California with \$25 billion from the cigarette manufacturers if diligent enforcement is executed.
- LPOs are viewed favorably by the local criminal justice system upon which the Board depends for prosecution of tax evaders. LPOs meet professional standards recognized by the law-enforcement community and their operations serve to reduce criminal activities and deter the growth of the underground economy.
- The citations written by LPOs streamline the enforcement process by providing a legally approved, widely recognized, and easier to administer set of procedures for misdemeanor prosecution, while fully protecting the taxpayer rights. Citations, which are an agreement to appear in court to face charges, eliminate the need for physical arrest, which would be required without citation writing authority.
- Increasing the current levels of LPO staffing would improve the effectiveness of the Alternative Cigarette Tax Stamp (ACTS) program and improve the overall inspection program cost-benefit ratio. Procedures require that each LPO is assigned to two 2-person inspection teams. An LPO must be present to write a citation and to testify in court. The LPO must travel between the two inspection teams, which often results in significant waiting time and extended taxpayer intrusion, as well as additional \$100,000 transportation expense. Under current levels of staffing there is no backup for the LPO who is appearing in court. (Attachment D). Therefore, an increase in LPOs is needed to optimize staffing ratios with the workload and achieve the criminal citation levels anticipated by AB 71 and the approved BCP.

Increasing LPO status for Investigations Division staff will: enable the Board to more fully execute its responsibilities under AB 71, enhance cigarette and tobacco products tax compliance levels, more diligently enforce the MSA, and more effectively deter the growth of the underground economy. Criminal citations have a greater deterrent effect than civil fines, and lead to enhanced compliance. As stated above and presented in the attached charts, enhanced compliance has already resulted in higher revenues, decreased illegal cigarette and tobacco product seizures, and has fostered a more legitimate, competitive market for distribution and sales in the cigarette and tobacco products industry.

Staff will continue to report to the Board every six months on the status and operational efficiency of the LPOs and the programs they enforce, and recommends the continuation of LPO status for 24 Investigations Division staff and the phase-in of an additional 53 Investigations Division staff, until the Board's legislative authority to grant LPO status expires on January 1, 2010.

KC:lm

Attachments

cc: Mr. Ramon Hirsig
Ms. Jean Ogrod
Mr. Tim Treichelt
Ms. Monica Brisbane
Mr. Gil Haas, Jr.
Mr. Randy Silva
Ms. Debbie Pelligrini

Board Members
August 24, 2005
Page 4

bc: Ms. Marcy Jo Mandel
Mr. Neil Shah

Limited Peace Officer Phase-in Plan

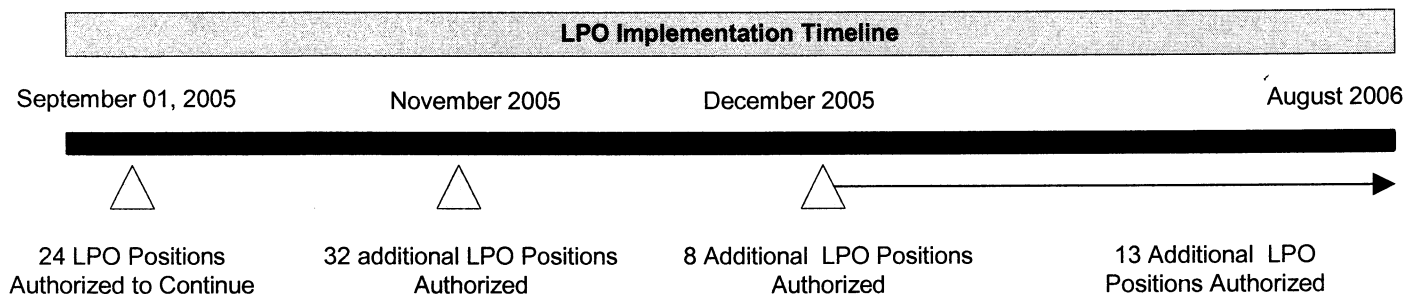
Discussion

This Limited Peace Officer (LPO) staffing phase-in plan incorporates the Legal Department's Investigations Division (ID) goal of having trained staff serve as LPOs. The ID proposes that the LPO status be limited to the Business Taxes Compliance Specialist level of classification, equivalent classification, or higher classification. This will ensure that the minimal level of professional achievement has been met to succeed as an entry level LPO within the Board of Equalization. In addition to minimum professional levels of achievement, the ID proposes that specific core training be required for all ID staff designated to receive LPO status.

ID has identified the following core classes: PC 832, Arrest Search and Seizure; Interview Techniques, Testifying in Court, Regulatory Investigative Techniques, Basic Tax Law, and Proposition 115/Testifying in Court certification. ID proposes that before any future staff obtain LPO status they must have 12 months on-the-job training within the ID and have completed all of the core courses previously identified.

Following is the proposed phase-in plan for continuing and increasing ID LPOs. This schedule proposes:

- 24 existing LPO staff continue as LPOs effective September 1, 2005
- 32 LPOs effective November of 2005 (The exact number may be less, dependant on completion of core training requirements.)
- 8 LPOs effective December of 2005
- 13 LPOs upon completion of the 12 months on-the-job training and the IDs core training requirements.



Estimated Yearly Revenue Increase from Cigarette and Tobacco Products Tax Enforcement
(SB 1701 & AB 71)

Item			Item		
1	Revenue Increase to General Fund	\$ 5,303,000 ¹	11	Additional packs of Cigarettes Sold	53,030,000 (from item 3)
2	Tax per pack to General Fund	\$ 0.10	12	Total Cigarette Tax per pack of cigarettes	0.87
3	Additional packs of Cigarettes Sold	53,030,000 (item 1/2)	13	Increase in total Cigarette Tax	46,136,100 (item 11 X 13)
4	Estimated Retail Price of a pack of cigarettes	\$ 4.00	14	Increase in Tobacco Products Tax	14,672,718 ²
5	Additional sales of Cigarettes	\$ 212,120,000 (item 3 X 4)	15	Total Increase in Excise Tax	60,808,818
6	Additional Tobacco Products Sales	\$ 57,034,074 ³			
7	Total Additional Sales of Cigarette and Tobacco Products	\$ 269,154,074 (item 5+6)	16	Total Additional Sales of Cigarette and Tobacco Products	\$ 269,154,074 (from item 7)
8	Percentage of Sales Tax to General Fund	5%	17	Average State and Local Sales Tax Rate	7.92%
9	Additional General Fund Revenue from Sales Tax	13,457,704 (item 8 X 7)	18	Total Increase in Sales Tax Revenue	\$ 21,317,003 (item 16 X 17)
10	General Fund 04/05 Revenue Increase	\$ 18,760,704 (item 1 + 9)	19	Total 04/05 Revenue Increase	\$ 82,125,821 (item 15+18)

¹ Cigarette Tax Revenues are taken from the June 8, 2005 Statement of General Fund Cash Receipts and Disbursements published by the State Controller.

	04/05	03/04*	Increase
General Fund Cigarette Tax (in thousands)	\$122,206	\$116,903	\$5,303

* AB 71 Cigarette and Tobacco Products Licensing Act of 2003 took affect January 1, 2004.

² This includes figures for June, 2004 through May, 2005. June, 2005 figures are not yet available.

In comparing the 12 months prior to the implementation of AB 71 (Effective January 1, 2004) to the 12 month period of June, 2004 to May, 2005 tobacco product distributions increased by \$31,378,782 or 39%. After applying the 46.76% tax rate the distributions the increase in revenue from Tobacco Products Tax was estimated to be \$14,672,718.
(2003 - \$80,146,334; June 2004 through May 2005 - \$111,525,116)

³ The wholesale cost of increased distributions for July, 2004 through May, 2005 with the Excise Tax and a 35% mark-up added was used as a conservative estimate of total retail sales

\$ 31,378,782	Increase in Revenue Distributions for 7/1/04 - 5/31/05
\$ 10,982,574	35% conservative retail mark-up on wholesale distribution amount
\$ 14,672,718	Tax addition of 46.76% of the wholesale distribution cost.
\$ 57,034,074	Estimated Additional Tobacco Product Retail Sales

Revenue Comparisons

CIGARETTES					TOBACCO PRODUCTS				
	2004	2003	DIFF		2004	2003	DIFF	REVENUE	
JAN	77,109,870	83,958,219	-6,848,349	-8.16%	8,084,907	6,536,643	1,548,264	23.69%	723,968
FEB	76,669,232	80,565,698	-3,896,466	-4.84%	7,953,004	5,941,765	2,011,239	33.85%	940,455
MAR	90,663,058	80,418,450	10,244,608	12.74%	9,797,200	6,345,060	3,452,140	54.41%	1,614,221
APR	83,535,899	86,777,802	-3,241,903	-3.74%	8,630,864	6,586,766	2,044,098	31.03%	955,820
MAY	86,395,446	83,753,247	2,642,199	3.15%	8,652,362	6,414,880	2,237,482	34.88%	1,046,247
JUN	92,518,454	85,676,513	6,841,941	7.99%	10,619,375	7,190,785	3,428,590	47.68%	1,603,209
JUL	85,891,556	94,778,026	-8,886,470	-9.38%	8,814,921	6,686,841	2,128,080	31.82%	995,090
AUG	90,303,087	95,885,163	-5,582,076	-5.82%	9,413,365	6,495,983	2,917,382	44.91%	1,364,168
SEP	91,036,224	80,791,496	10,244,728	12.68%	11,144,866	7,647,033	3,497,833	45.74%	1,635,587
OCT	82,380,039	91,798,745	-9,418,706	-10.26%	8,548,165	6,890,959	1,657,206	24.05%	774,910
NOV	80,630,683	72,158,272	8,472,411	11.74%	8,989,877	5,899,353	3,090,524	52.39%	1,445,129
DEC	93,757,941	87,809,413	5,948,528	6.77%	9,239,714	7,510,266	1,729,448	23.03%	808,690
TOTAL	1,030,891,489	1,024,371,044	6,520,445	0.64%	109,888,620	80,146,334	29,742,286	37.11%	13,098,803

Estimated recovery (assuming 3.0% decline) 37,251,576
Estimated recovery (assuming 5.37% decline) 61,529,170

Historical Taxable Distributions (Millions of Packs)

1998-99	1,523	-11.16%
1999-00	1,353	-4.80%
2000-01	1,288	-4.11%
2001-02	1,235	-3.16%
2002-03	1,196	-5.37%
Avg before AB - 71		
2003-04	1,184	-1.00%
2004-05	1,184	0.00%
Avg after AB - 71		0.00%

CIGARETTES				TOBACCO PRODUCTS			
	2004	2005	DIFF		2004	2005	DIFF
JAN	77,109,870	68,665,351	-8,424,519	-10.93%	8,084,907	8,456,278	371,371
FEB	76,669,232	79,000,245	2,331,013	3.04%	7,953,004	8,124,206	171,202
MAR	90,663,058	97,302,899	6,639,841	7.32%	9,797,200	10,519,867	722,667
APR	83,535,899	80,097,554	-3,438,345	-4.12%	8,630,864	8,754,679	123,815
MAY	86,395,446	91,703,786	5,308,340	6.14%	8,652,362	8,886,328	233,966
JUN	92,518,454	88,950,627	-3,567,827	-3.86%			
TOTAL	506,891,959	505,740,462	-1,151,497	-0.23%	43,118,337	44,741,358	1,623,021

Estimated recovery (assuming 3.0% decline) 14,055,262

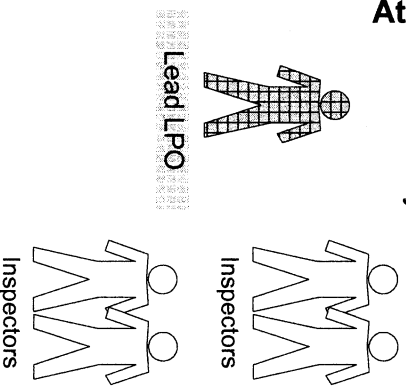
Investigations Division Monthly Activity Report
Fiscal Year 2004 - 2005

Line		Jul - 04	Aug - 04	Sep - 04	Oct - 04	Nov - 04	Dec - 04	Jan - 05	Feb - 05	Mar - 05	Apr - 05	May - 05	June - 05	TOTAL	Line
1	Civil Citations														1
2	Civil Citations - Number Issued					42	61	55	91	86	96	85		516	2
3	Number of violations					65	103	87	147	147	152	134		835	3
4	Criminal Citations														4
5	Criminal citations - Number Issued											7		7	5
6	Number of violations											15		15	6
7	Compliance Inspections & Seizures														7
8	No. of retail inspections done	900	1,021	1,109	956	692	625	477	715	580	717	628		8,420	8
9	No. of wholesaler inspections done	-	52	5	3	7	3	1	3	1	3	5		83	9
10	No. of distributor inspections done	1	51	10	16	5	3	2	6	3	-	4		101	10
11	No. of Penal Code Section 308(a) violations	44	45	20	14	34	9	21	35	10	54	36		322	11
12	No. of cigarette seizures	149	168	166	147	123	63	58	82	87	63	81		1,187	12
13	Total amount of cigarettes seized (sticks)	558,640	531,904	960,692	670,206	1,178,160	350,460	354,328	404,900	341,418	444,754	285,960		6,081,422	13
14	Avg. cigarettes taken per seizure (sticks)	3,749	3,166	5,787	4,559	9,579	5,563	6,109	4,938	3,924	7,060	3,530		5,123	14
15															15
16	No. of Tobacco Seizures	3	5	8	9	8	5	9	15	14	21	5		102	16
17	Total wholesale cost of tobacco products seized	526	574	951	890	703	4,878	12,518	10,011	27,915	7,584	3,582		70,131	17
18	Avg. wholesale cost of tobacco products seized	175	115	119	99	88	976	1,391	667	1,994	361	716		688	18

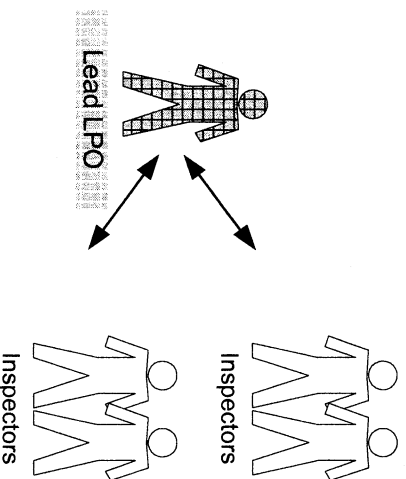
Current LPO Working Model (Example Week)

Attachment D

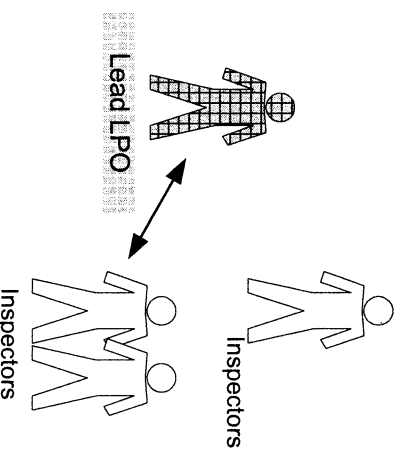
Monday



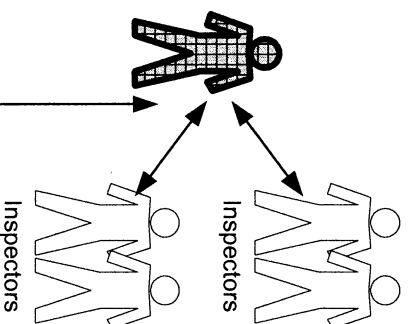
Tuesday & Wednesday



Thursday



Friday



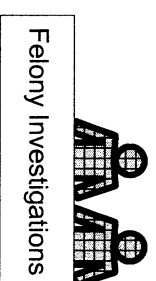
All staff scheduled in to conduct background work, prepare reports, obtain rental vehicle for Lead LPO

Any one-day unscheduled leave by an LPO requires all four inspectors to remain in the office, as they lack inspection and citation authority.

All inspection team staff in field, extra per diem, and vehicle required to have LPO roving between inspection teams. Added cost to operate under this model totals \$100,000 per year.

Inspection staff must wait for LPO if other inspection team has a citation being issued. In these situations, taxpayers have had to wait up to an hour for an LPO to arrive to issue a citation.

When an inspector is absent, the other team inspector must work in the office, as the LPO cannot effectively conduct inspections and respond to another team operating in the area to issue a citation. In these situations, inspection activity is effectively cut in half.



When an inspection LPO is scheduled for leave or training, a felony investigative LPO must be scheduled to backfill, requiring the redirection of felony investigative resources and additional program per diem and travel costs.

Legend



Lead LPO



Non LPO



Investigative LPO



LPO Inspector